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TAGS: [MTCRE](#) [ETTC](#) [KSCA](#) [MNUC](#) [PARM](#) [TSPA](#) [FR](#) [UK](#) [AS](#)  
SUBJECT: MISSILE TECHNOLOGY CONTROL REGIME (MTCR):  
SHIPPING AND PROLIFERATION: INDUSTRY OPERATIONS AND THEIR  
BENEFITS TO PROLIFERATORS

Classified By: ISN/MTR DIRECTOR PAM DURHAM FOR REASONS 1.4  
(B) AND (H).

¶1. (U) This is an action request. Please see paragraph 2.

¶2. (C) ACTION REQUEST: Department requests Embassy Paris provide the interagency cleared paper "Shipping and Proliferation: Industry Operations and Their Benefits to Proliferators" in paragraph 3 below to the French Missile Technology Control Regime (MTCR) Point of Contact (POC) for distribution to all Partners. Department also requests Embassy London provide paper to the MTCR Information Exchange (IE) Co-Chair (John Andrews), and Embassy Canberra provide paper to the Australian MTCR Plenary Chair for 2008/2009 and/or appropriate staff. Info addressees also may provide to host government officials as appropriate. In delivering paper, posts should indicate that the U.S. is sharing this paper as part of our preparation for the Information Exchange that will be held in conjunction with the MTCR Plenary in Canberra (November 3-7). NOTE: Additional IE papers will be provided via septels. END NOTE.

¶3. BEGIN TEXT OF PAPER:

SECRET//REL MTCR

Shipping and Proliferation: Industry Operations and Their Benefits to Proliferators

Maritime commercial transport plays a vital supporting role in the proliferation of WMD/missile delivery systems and related materials. Maritime transport provides the most cost effective method of moving large, heavy materials between continents. Depending on the route and items shipped, shipping items by air can cost dollars per kilogram, whereas shipping the same items via maritime means is likely to cost only pennies. The savings are exponential, especially when dealing with high-weight and/or high-volume items like specialty metals or bulk chemicals. While the smallest or most sensitive items are likely to go by air when possible, there is no cost-comparative substitute for maritime shipping.

This paper will explore aspects of the two primary elements of the commercial shipping industry: the ships and the cargo. The first section will review elements attached to the ship itself: its nationality, ownership, management, and insurance. The second section will examine the standard ways cargo moves

through the international shipping system of today, and how the characteristics of this system can assist or hinder proliferators in their attempts to ship cargoes of interest.

## **Ships**

The most basic and important element of the maritime shipping industry is the ship. As part of a trade exchange, the ship itself plays a key role in the financial transaction that allows buyer and seller to exchange money for goods - banks will not release funds to the seller until presented with proof that the cargo was loaded for delivery. This documentary proof, in the form of the Bill of Lading (BOL), names the ship on which the cargo has been loaded. To participate in legitimate trade, a ship must have a flag, an owner, and usually requires insurance. The ship will also operate in one of two ways, as a tramp or a liner service.

**Registration and Flagging:** When operating in international waters, a ship is governed by the law of the country whose flag it flies. A ship gains the right to fly a nation's flag by joining its ship registry. Many nations operate what are called "open registries," also known as "flags of convenience." Under an open registry, ships from outside that country are allowed to register with that country and fly that nation's flag for a fee. Flags of convenience (FOCs) frequently offer significant benefits to ship owners over flying national flags: these include lower registry fees, lower taxes on annual trade activity, or more lenient legal or safety requirements.

The use of FOCs for international trade is widespread. The use of open registries disconnects the nationality of the ship from the nationality of the flag which it flies: a ship may fly the flag of a country without ever having called in one of its ports. While some FOCs require that the registered owner be located in their state, the flag of a vessel does not necessarily reflect the nationality of the owner or operator of the ship.

**Insurance:** In order to conduct trade, a ship is usually required to carry several kinds of insurance. In addition to insurance on the cargo, which is normally arranged by the shipper or consignee, ships themselves are usually required to carry two types of insurance. Protection and Indemnity (P&I) insurance covers any damage the ship may cause through environmental harm, accidents in port, or other incidents. Hull and Machinery (H&M) insurance covers the ship itself and damage or loss thereof. While ships may choose to operate without H&M or cargo insurance, many ports require ships calling in their waters to carry proof of P&I coverage. If a ship cannot prove that it has such insurance, the port state may choose to refuse access to the port.

P&I insurance is generally the most important type of insurance. It is generally procured through access to cooperative groups called P&I clubs. Members of P&I clubs cover each other's losses through pooled funds based on premiums and supplemental funds. With P&I insurance, an owner enters his fleet or a part thereof, all of which is covered under one annual premium to the club. If a line is denied entrance into one of these clubs, the company may choose to self-insure. Under self-insurance, a company sets aside reserve funds for each ship, out of which claims are paid out. While this is often a respectable method of insuring, it does not allow for shared coverage of risk and exposes the company to considerable losses should an incident occur.

**Ownership and Management:** A ship may have multiple

legal owners. There are two major types of ship ownership: beneficial ownership and registered ownership. The beneficial owner is considered the ultimate legal owner of the ship. As implied by the name, the beneficial owner is the ultimate financial beneficiary of the ship's activities. Due to the appealing nature of open registries, the beneficial owner is not always a resident entity of the country in which the ship is registered. In many cases, open registries require that a ship have local ownership to enroll in that nation's registry. In these situations, it is common for the beneficial owner to establish a separate company in that country as the nominal owner of the ship, or to contract a local firm to act as owner. This local company is known as the registered owner of the ship. For liability purposes, it is not unusual for a company registering numerous ships under a FOC to establish separate companies to serve as registered owner for each individual ship. By maintaining such small companies, the parent organization thereby hopes to avoid exposing its entire fleet and other corporate assets to lawsuits in the event one of its ships is involved in a catastrophic accident. In many cases, the nominally-independent registered owner will then lease, or charter, the ship back to the beneficial owner so that the beneficial owner then controls the ship's daily operations. While the different levels of ownership can be confusing to an outsider, these ownership structures are very common in the industry, which considers the beneficial owner to be the true owner of the ship. In fact, many registries require that the registered owner disclose the beneficial owner's name, address, and contact information on the registry application forms.

The entity that is in charge of the ship's day-to-day operations, including bunkering, scheduling, agents, and booking of cargoes is known as the ship's operator. The ship's operator may be the ship's registered owner, the beneficial owner, or an independent third party. Many beneficial owners have little or nothing to do with the daily operations of the ship, and may not even know where the ship is sailing. Instead, the operator of the ship sets its port calls, books cargoes, and is responsible for arranging for the daily needs of the ship.

**Tramp versus Liner Services:** In general, there are two ways a ship moves to load and discharge cargo. Ships on liner services move on a regular, repeated schedule between a set of ports. This predictability means that the ship has a set period of time between calls at a particular port. Usually, a shipping line will put several ships onto the same port rotation at regularly spaced intervals in order to ensure that that company will have a ship arriving in port every so many days, with the frequency depending on the amount of cargo that is available to move into or out of that port. A liner service is in many ways comparable to a city bus line: the ships show up at published, predictable intervals and times, and generally stop at the same locations each time. Liner services transport primarily containerized cargo, allowing ships to stay on schedule due to the uniformity of shipping containers.

The second way a ship can operate is as a tramp service. In this type of operation, a ship does not have a predictable or repeated port rotation. Instead, the ship's port calls change from voyage to voyage, depending on cargo availability. Where a liner service is similar to a bus route, the tramp service is comparable to a taxi for hire: it does not always go to the same places, or drive the same streets, but goes where the passengers need to go. Many tramp ships are bulk or breakbulk carriers, and as such, can transport containerized and non-containerized cargoes depending on the customers' needs.

## Cargoes

In the shipping world, there are three types of cargoes: bulk, containerized, and breakbulk. Large quantities of unpackaged, loose materials are called bulk cargoes. These can be liquid or solid, and are usually moved via bulk carriers, which are characterized by large open hold spaces and often have specialized handling equipment. However, this paper is only concerned with containerized and breakbulk cargoes, since these types are the majority of proliferation-related cargoes. Both containerized and breakbulk shipping methods can provide a proliferator with different benefits and vulnerabilities.

**Containerized:** The largest trend in the maritime shipping industry in the last forty years is the adoption of the use of shipping containers. The hallmark of containerized shipping is the placement of cargoes in standardized, reusable steel shipping containers. The average shipping container is 20 or 40 feet long, although specialized sizes are available. This standardization allows for improved ease and speed of handling, and provides increased security and anonymity to valuable shipments.

In order to more efficiently funnel cargoes from smaller ports to the larger or vice versa, the containerized shipping industry relies on hub-and-spoke type route operations. Larger container ships, capable of carrying thousands of containers, tend to call only at the largest ports, known as "hub ports." Cargoes destined for smaller ports that cannot receive these large container vessels are offloaded in hub ports in a process known as transshipment. These containers are then loaded onto smaller ships, operating on "feeder services" for final delivery, or onto another larger vessel traveling to a further destination. It is not uncommon for containers to undergo multiple transshipments in a single voyage. Nor is it uncommon for a container to transit an apparently circuitous route to its destination, as the route depends on available cargo space on shipping routes and cost-benefit analysis.

For a proliferator trying to move sensitive goods, containerized shipping can offer considerable benefits. Because of the uniform packaging of cargoes in shipping containers, containerized shipping methods can easily disguise the true nature of a shipment. Unless the contents of the container are physically inspected - a lengthy process rarely undertaken by customs authorities of exporting or transiting countries - the cargo declaration on the bill of lading is usually accepted by all as the true description of the cargo. In the absence of verification, it is easy for duplicitous shippers to "misdescribe" or falsify the contents of the container. Even the ship's master and crew will have no idea of what is in the hundreds or thousands of containers on their ship beyond what is written in their documentation. Additionally, general descriptions such as "Freight of All Kinds" are still widely accepted in the shipping industry - a description that although legal, is not informative to the authority trying to identify cargoes that violate export controls. Besides anonymity, containerized shipping can provide a considerable savings over breakbulk shipping, because of the economies of scale enjoyed by the industry.

On the other hand, containerized shipping leaves a proliferation-related cargo vulnerable in many ways. The hub and spoke system, while cheap, can be considerably slower - especially as a cargo undergoes multiple transshipments en route to or from a less serviced port. Additionally, as a cargo awaits

transshipment in a hub port, it represents an opportunity for cognizant authorities to inspect and hold suspect cargoes, as allowed by national or international authorities, such as UNSCR 1803, which calls upon member nations to examine the cargoes of the Islamic Republic of Iran Shipping Lines provided there are reasonable grounds to believe that the vessel is transporting goods prohibited under UNSCR 1803 or previous Chapter VII UNSCRs (1737 and 1747).

Breakbulk: Not all proliferation-related cargoes are containerized. Breakbulk cargoes are those that are usually too large or unsuitable for shipment in standard twenty- or forty-foot long shipping containers, although any cargo can be shipped without a shipping container. Cargoes can be on pallets or in crates - larger items such as piping or metals may be laid in bundles inside holds. (Sometimes shipping containers are used to ship cargoes on breakbulk ships. Because these cargoes are handled by tramp vessels and not the standard containerized shipping routes, for the purposes of this paper they are considered breakbulk.) These cargoes are therefore exposed and vulnerable to theft or damage. Because breakbulk cargoes are more difficult to handle than containerized cargoes, breakbulk cargoes are rarely transshipped. Instead, breakbulk cargoes are usually carried by ships operating on tramp services. While a tramp ship carrying breakbulk cargoes may make multiple stops in one voyage to load and offload multiple cargoes, a customer with enough cargo, influence, and/or money can request a point to point voyage with no intermediate stops. This point-to-point service can also be accomplished by the customer chartering - or leasing - the vessel itself.

These point-to-point voyages can provide considerable security to a proliferation-minded customer, but lack the anonymity inherent in containerized shipping. Since the cargo is at sea for the entire voyage, the shipment is not exposed to the vulnerability of transshipment. Both North Korea and Iran have embraced breakbulk point-to-point shipments as a secure means to transport sensitive cargoes while avoiding interference. On the other hand, this kind of shipment can be much more expensive than containerization. Since the cargo is exposed, the crew and master are more likely to be aware of the nature of the cargo and what it is. The unusual nature of point-to-point voyages between countries of concern can sometimes provide cognizant authorities a clear tip-off to a shipment of concern not provided by the containerized shipments carried by liner services.

#### Conclusion:

Ultimately, the single greatest influence on the operations of the shipping industry - and even on proliferation-minded networks and procurers - is profit. Proliferators rely on maritime shipping because the costs can often justify both the longer transit times and the various inherent vulnerabilities that cargoes moving slowly across the ocean or through other ports possess. Both North Korean and Iranian networks have been known to weigh the benefits and risks against the sensitivity of their shipments when choosing how they will transport their materials, sometimes choosing point-to-point breakbulk deliveries, but at other times preferring to utilize the international containerized shipping infrastructure. These choices appear to be influenced not only by the types of materials involved, but also by matters of cost and sensitivity to transshipment vulnerabilities.

END TEXT OF PAPER.

14. (U) Please slug any reporting on this or other MTCR issues for ISN/MTR. A word version of this document

will be posted at [www.state.sgov.gov/demarche](http://www.state.sgov.gov/demarche).  
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